BUILDING THE NEW BRITISH COLUMBIA ECONOMY: DEVELOPMENT AND DIVERSIFICATION

presented to the

Western Premiers' Conference

May 29-30, 1986

by the

Hon. W. R. Bennett
Premier
Province of British Columbia

Province of British Columbia

May 1986

86-05188/

BUILDING THE NEW BRITISH COLUMBIA ECONOMY: DEVELOPMENT AND DIVERSIFICATION

Presented to the

Western Premiers' Conference

Swan River, Manitoba

May 29-30, 1986

By

The Honourable William R. Bennett

Premier of the Province of British Columbia

Introduction

The economy of British Columbia has experienced over the past five years a period of adversity and change among the most significant in the province's history. The effects of a severe international recession and the underlying structural — rather than cyclical — changes in the world economy have made this a particularly challenging period for government economic policy. What has emerged from this period is a new policy framework aimed at building the new British Columbia economy which will carry the province into the next century.

The 1981-82 World Recession

The effects of the 1981-82 world recession were sharper and the required adjustments to a new economic environment evident earlier in British Columbia than in most other provinces. Restrictive monetary policies imposed in late 1979 by the U.S. Federal Reserve Board and the Bank of Canada had succeeded by 1982 in reducing inflation, but the accompanying high real interest rates had propelled the economies of the industrialized nations into a deep and prolonged recession. The resulting decline in demand for many natural resource products sharply reduced the value of British Columbia's exports. The effects of declining prices for British Columbia's commodities — which are now spreading to commodities produced in other provinces — rippled through the entire economy as corporate losses mounted and many operations were shut down. Major cost-cutting efforts were required for most of British Columbia's natural resource producers to stay in business. Layoffs resulted as higher-cost plants curtailed production and many jobs were permanently eliminated in cases where plant and equipment were modernized to improve productivity. As a result, the province's unemployment rate rose sharply, the growth of consumer income and expenditure slowed significantly, and investment and construction activity declined.

The international recession also caused a deterioration in British Columbia's finances. Personal and corporate income tax and sales tax collections grew very slowly or actually declined. Natural resource revenues, which contributed almost a quarter of total revenue in 1979/80, dropped by 58 per cent in the ensuing three years. Meanwhile, the recession caused increased demands for social assistance, and population-driven expenditures on health care and education continued to grow rapidly. The result was a large and growing deficit which threatened to destabilize the provincial government's finances. Quick action was required to control the deficit and prevent the excessive accumulation of public debt. The alternative was to allow a growing debt burden to crowd out spending on government programs and lead to massive tax increases.

In early 1982, the provincial government introduced a general program of spending restraint and an innovative Compensation Stabilization Program, in order to reduce the burden of government on the private sector. These two initiatives were designed to reduce the expenditure base of the provincial government by eliminating less essential programs, increasing the efficiency of government administration and limiting the rate of increase in public sector compensation. Today, British Columbia is one of only three provinces in which public sector wage settlements follow — and do not lead — private sector settlements. By acting quickly to reduce the cost of government, the government stabilized and then reduced the deficit without threatening core social programs. British Columbia's deficit as a percentage of Gross Domestic Product is now the second lowest among the ten provinces.

The increased fiscal flexibility afforded by these expenditure reduction efforts allowed the government to introduce its Economic Renewal Program. Through major business tax reductions, incentives, and selected increases in development expenditure, British Columbia industry has been put on a more competitive footing. These initiatives have formed an important part of the government's commitment to invest in the people of British Columbia, renew the natural resource base, increase trade, diversify the economy and encourage the entrepreneurship needed to build a more dynamic and competitive provincial economy.

The success of efforts to date is evident. In January 1985, the actual unemployment rate peaked at 16.4 per cent. Between January 1985 and April 1986, employment in British Columbia increased 5.6 per cent and the seasonally-adjusted unemployment rate fell from 14.6 per cent to 12.4 per cent. The province's economy is estimated to have grown 3 per cent in 1985 and is forecast to grow by 4 per cent in 1986 and 3 per cent in 1987. Stronger economic growth, combined with policies of expenditure restraint, have enabled the government to reduce its deficit without resorting to tax increases that would have inhibited growth and made British Columbia a less competitive place to do business.

Concomitant with these economic achievements has been a much improved state of industrial relations in the province. In 1985, British Columbia had its best industrial relations record in twenty years; only 148,000 worker days were lost compared to 3.2 million in 1981. The Critical Industries Commission, established in 1985, has been successful in bringing business, labor and government together to save threatened firms. It is an example of the type of co-operation that has improved industrial relations and productivity in British Columbia.

The Changing Economic Structure and Environment

While addressing the province's fiscal problems and helping British Columbia industries become more cost competitive, the government has also focused on longer-term trends in the world economy. An important question was whether the weakness in natural resource markets was a temporary cyclical event or a longer-term phenomenon.

Several factors have combined in recent years to slow the recovery of key commodity prices. Persistent excess production capacity has meant that world supply has outpaced demand, precluding any significant price increases. For British Columbia, this has been most evident in the lumber industry, where high sales volumes have not been accompanied by significant, sustained increases in prices. There have been similar developments in the markets for British Columbia's major minerals. These conditions are unlikely to change in the near future.

As a result, while traditional resource-producing and exporting industries will continue to generate large shares of income and employment in the province, they can no longer be relied upon solely to provide rapid economic growth in the late 1980s and 1990s. In addition, physical limits on the potential output of the province's resource base will constrain expansion of volumes available for processing. This effect may be offset to some extent as resource industries move toward further processing to produce higher value products. It is also projected that other sectors of the economy, such as the service industries, will grow considerably faster than the traditional goods-producing industries in terms of employment and output, continuing the trend of the recent past.

The Implications of the Changing Economic Structure

Industrial and technological change is altering the traditional view that British Columbia's prosperity is solely dependent upon the growth of basic resource extraction and processing industries. New industries are exploiting some of British Columbia's natural advantages as well as the expertise gained in traditional activities. Rather than solely "feeding off" the traditional economic base, some service industries are becoming increasingly important components of the economic base in their own right. Activities such as tourism, film production, consulting and financial services are playing a growing role in expanding the wealth-creating base of the British Columbia economy.

Also contributing to the rapid growth of non-traditional industries has been the evolution of the information economy. Rapid advances in technology have resulted in:

- productivity gains and product improvements in existing industries;
- development of new products, new industries and new employment;
- new export markets.

The use of advanced technology to develop cost-reducing innovations and production processes will be a key element in the future profitability and efficiency of British Columbia's traditional natural resource industries. In addition, the application of technology will be essential to enhancing the capacity of the natural resource base to support production.

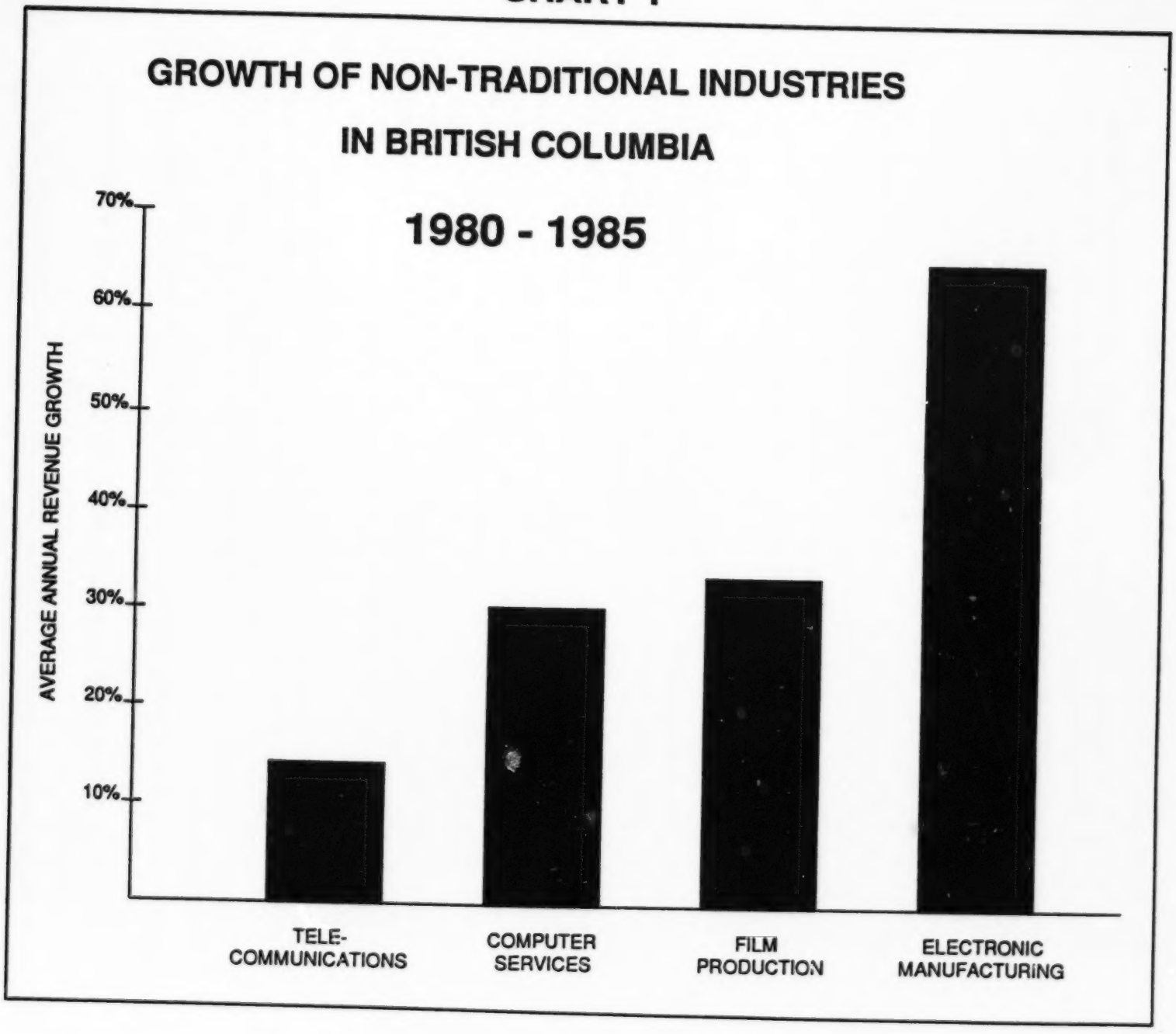
While British Columbia is unlikely to become a major manufacturer of mass-market products in the short term, market niches do exist and have been exploited by British Columbia firms. In some cases, the firms occupying these niches have taken advantage of existing knowledge and expertise in the province's natural resource industries. In other cases, new development has occurred in areas unrelated to traditional economic activity in British Columbia. The result has been increased employment in small businesses involved in research and development, manufacturing, distribution, sales and services, and in new industries such as microelectronics, robotics, film-making and aquaculture. Chart 1 illustrates the extremely rapid growth rates achieved by some of these new industries in recent years.

In addition to generating productivity and product improvements and creating new products and industries, technology and information themselves can be exported. When British Columbia architectural or engineering firms go abroad to design a building or a dam, they are exporting knowledge, expertise and technology, but little of what have been traditionally considered exports.

There are numerous developments of the type described above that have been facilitated by government policies. Examples include:

- further processing involving the application of new technology to utilize resources more efficiently;
- diversification and expansion based on accumulated resource industry knowledge; for example, incorporating new technology into sawmills and capital equipment used in the resource industries;
- development of local capabilities and export potential in service industries such as consulting, engineering, architecture, repair services;

CHART 1


GROWTH OF NON-TRADITIONAL INDUSTRIES
IN BRITISH COLUMBIA
1980 - 1985
AVERAGE ANNUAL REVENUE GROWTH
70%
60%
50%
40%
30%
20%
10%
TELE-COMMUNICATIONS
COMPUTER SERVICES
FILM PRODUCTION
ELECTRONIC MANUFACTURING

- local production of goods and services previously imported;
- tourism, including significant increases in convention activity;
- film production and related cultural and technical activities;
- financial services, with particular emphasis on developing a Pacific Rim financial centre in Vancouver;
- high-technology/information-based industries such as software development, biotechnology, aquaculture, robotics, alternative energy development, computer mapping and remote sensing.

Another trend that will affect British Columbia is the shifting pattern of world trade. There is increasingly strong competition from the less-developed and newly-industrializing countries. While this may erode some of British Columbia's traditional advantages in its main export markets, the growth in incomes and living standards in these rapidly developing countries will also provide new export opportunities for a range of products.

In addition to diversification of goods and services produced, British Columbia has also diversified its trading patterns. The United States remains British Columbia's largest export market, although its significance has decreased over time. In 1962, approximately 65 per cent of British Columbia's exports were shipped to the United States. By 1984, this had dropped to 47 per cent.

Initiatives to achieve a freer trade arrangement with the United States are potentially important for British Columbia. Although most of this province's goods exports already enter the United States duty-free, protectionist measures and threats have grown more numerous recently. Further, British Columbia exporters of services have encountered increasing difficulties in gaining access to the American market because of a range of complex non-tariff barriers. Finally, a free trade agreement would stabilize access to the major consumer markets south of the border — essential to the further growth of manufacturing in the province.

Government Policies for the Future

The main thrust of the Economic Renewal Program was to help put industries on a more competitive footing and to assist individuals and companies in the process of adapting to the long-run structural changes in the economy.

This year's British Columbia Budget continued the process of economic renewal, with added emphasis on "framework" policies to assist in the development of new types of economic activity in the province. The increasing importance of non-traditional markets and industries, the possibility of a liberalized trade arrangement with the United States, and the growing emphasis on goods embodying higher levels of technology and expertise require continued adaptation of government policy to help British Columbians realize the economic opportunities the next decade will offer.

In general terms, government policy will establish a framework for future economic development that:

- provides workers with the tools to make them employable regardless of the changes brought on by a rapidly evolving economy;

- creates a tax and regulatory climate that is competitive with those of other jurisdictions;
- provides funds for public investments that improve the resource base and the ability to transport products to market;
- promotes the development of new markets for the province's goods and services.

In pursuing these objectives, government initiatives have been undertaken in a number of areas outlined in the Appendix.

The Government of British Columbia supports a liberalized trade arrangement between Canada and the United States to provide more secure access to the American market and is prepared to take the necessary steps — including further dismantling of barriers to inter-provincial trade — to help in reaching an agreement that is in the best interests of British Columbians. In addition, the government continues to support a new round of multilateral trade negotiations as an essential ingredient of a more healthy and open world trading system.

British Columbia's Economic Prospects

British Columbia's forward-looking fiscal strategy and Economic Renewal Program will result in a more flexible, diversified and stable economy, a stronger revenue base, a productive and modern public capital stock and an economic climate conducive to investment, risk-taking and job-creation.

As the British Columbia economy continues its recovery from the recession of 1981-82, the long-awaited improvement in markets for non-energy resource exports may now be starting. The slow recovery of export markets has heightened awareness of the economic benefits of other activities, such as service exports (including tourism), secondary manufacturing, and the commercial application of scientific research, as well as the diversification of the resource industries.

The government cannot dictate the direction the economy will take, but can influence it by developing policies to ensure that the economy as a whole and individual British Columbians can adapt with relative ease to future changes. Insulating people and businesses from external change is no solution as this course would also insulate the province from opportunities. Moreover, it simply is unaffordable given the precarious state of public finances in Canada. The wide range of policies that have been introduced by the government will help to build a new British Columbia economy by encouraging the province's residents and businesses to adapt to, and take advantage of, the challenges of a changing world economy.

The Western Economy in Transition

Factors such as declining commodity prices that affected the British Columbia economy in the aftermath of the 1981-82 recession are now having an adverse impact on the economies of the other Western provinces. To deal with the economic challenges that will be presented in the coming months and years, a co-ordinated and co-operative approach by governments is needed. It is essential that we build on the natural strengths of the Western provinces to diversify their economies and to take maximum advantage of the more competitive world

trading environment that will emerge from Canada-United States and multilateral trade negotiations.

In recent years, federal-provincial co-operation has improved considerably. This more positive atmosphere provides an opportunity for the two orders of government to address together the issues affecting the Western provinces' economies. Accordingly, the Government of British Columbia is proposing that a federal-provincial conference be held on "The Western Economy in Transition", perhaps modelled on the Western Economic Opportunities Conference held in 1973. The agenda of this conference could include discussions on transportation, economic and industrial diversification, agriculture, fisheries, tariffs and regional financial institutions. It is time to renew the focus on Western Canada — both its problems and opportunities.

APPENDIX

Outlined below are some of the measures included in the Government of British Columbia's Economic Renewal Program.

Renewal of the Resource Base

- $300 million, 5-year Forest Resource Development Agreement with the federal government
- special Forest Stand Management Fund of $20 million to provide for weeding and thinning of replanted areas and other silviculture treatments (additional contributions are being sought from industry, labour and other levels of government)
- $10 million, 5-year Mineral Development Agreement with the federal government
- $5 million incentive program for mineral exploration and development
- cost-based incentive pricing for large volume industrial electricity consumers
- appointment of Critical Industries Commissioner to achieve agreements among business, labour and government to ensure the survival of threatened firms in the forestry and mining industries

Economic Diversification/Trade Development

- commitment by the government to secure access to the American market by participating with the federal government in the negotiation of trade liberalization with the United States
- establishment of overseas trade offices to promote British Columbia exports and assist British Columbia businesses abroad
- additional emphasis on service export promotion
- development of Vancouver as an international financial centre
- establishment of an international business dispute arbitration centre in Vancouver
- establishment of the Discovery Enterprise Program to assist in the start-up of high-technology businesses
- funding of convention centres in Vancouver, Victoria, Kelowna, Whistler and other locations in the province and establishment of Conventions B.C., a marketing organization
- promotion of British Columbia as an important film-making location

Educational Investments

- Fund for Excellence in Education will provide $600 million over the next three years to improve the quality of teaching and research, to respond to economic development opportunities, to establish centres of excellence, to modernize facilities and equipment, to improve efficiency in operations, and to promote the participation of qualified students in post-secondary education

- expansion of secondary school curricula to include new courses in science and technology, computer science and foreign languages
- increased emphasis on general education with foundations in mathematics, science and computers
- on-going Science Council of British Columbia support for applied research programs at the universities

Renewing the Entrepreneurial Spirit

- Small Business Venture Capital Corporations, designed to provide tax-assisted financing to companies involved in tourism, aquaculture, manufacturing and processing, research and development, and export-oriented service industries
- direct government involvement in, and financial assistance for, various types of business information centres throughout the province, designed to help businesses to start and expand
- a wide range of tax reductions designed to increase rewards from entrepreneurial efforts and to make British Columbia's tax system competitive with those of nearby provinces and states (see Table 1).

TABLE 1
Economic Renewal Taxation Measures

	REVENUE IMPACT		
	1986/87	1987/88	1988/89
	($ million)		
Corporation Capital Tax phase-out (except for major banks with head offices outside British Columbia)	– 40.0	– 60.0	– 90.0
Small Business Employment Tax Credit	– 44.0	– 68.0	– 38.0
Venture Capital Tax Credit	– 10.0	– 10.0	– 10.0
Phase-out of property tax on machinery and equipment	–125.7	–168.8	–177.0
Reduction of non-residential school property tax rates and property tax reductions for new industrial improvements	– 43.3	– 92.0	–100.0
Freezing of water rental rates for hydro-electric power generation	– 28.5	– 43.0	– 58.0
Other measures	– 68.1	– 71.0	– 72.3
TOTAL	–359.6	–512.8	–545.3

Queen's Printer for British Columbia ©
Victoria, 1986